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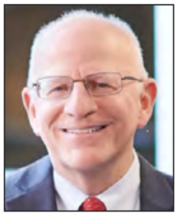

2023's Top Thirty Legal Trends for Automobile Dealers

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INTRODUCTION

Like no other Supreme Court term in history, two SCOTUS decisions in June 2022 could reverberate for federal agencies for a long time, narrowing their bureaucratic ability to assert and enforce the kind of authority they have wielded for decades. During the ongoing 2022-2023 term, this #1 legal trend for America's auto dealers in 2023 may cut into the federal regulatory governance of America's auto industry and directly affect what dealers will have in stock for their retail customers, and how such retail businesses may conduct their sales and service.

Why is this legal trend #1 for dealers? The simple answer is, first, that federal regulatory bureaucratic interference hurts every single dealer with hundreds of thousands of dollars in wasted annual expense, <u>and</u> it distracts employees away from necessary dealership tasks. Second, SCOTUS and lower courts could be the catalysts of tamping down the many ways that federal agencies police American dealerships and cause them unnecessary and duplicative cost and work time.

Together, *Dobbs v. Jackson Women's Health Organization,* and *West Virginia v. Environmental Protection Agency,* may forecast the diminishment of federal power, returning much of it to the states. Without the necessary enabling specificity in the text of Congressional enactments, federal agencies are apt to lose much of their hold over dealers. Lower courts are already heeding the SCOTUS June 2022 precedents. The current SCOTUS majority likely signals more decisions headed in the same direction, not only from SCOTUS, but also from lower federal courts.

For example, despite recent Federal Trade Commission ("FTC") initiatives to increase its regulatory and enforcement hold over auto dealers, over time, it could see federal courts strip the FTC of much of its enforcement power against auto dealers. *See,* Sventlana Gans and Eugene Scalia, "The FTC Heads for Legal Trouble: Its aggressive rule-making will create opportunities for judges to rein in the commission's authority." *Wall Street Journal*, Aug. 8, 2022. On October 19, 2022, a federal appellate court issued a decision virtually stripping the Consumer Financial Protection Bureau ("CFPB") of its funding source; the agency has petitioned SCOTUS for review.

As a separate SCOTUS issue affecting dealers (#8), the use of affirmative action based on race in university admissions may be declared unlawful in two cases pending decision in 2023. For dealers, that development would invite legal challenges to DEI policies from prospective and current employees across the business spectrum, including dealerships.

At #2 for 2023 is the continuing battle over whether manufacturers should be able to retail directly to consumers anywhere in the U.S., especially with EVs.

As this year's #3 trend indicates, product shortages still plague almost every dealer. No end is yet in sight, even though shortages should be less severe than in 2022. Some brands still admonish their dealers for "failing" to retail the objective-driven numbers of new units that the franchisor cannot or will not provide to dealers. This is franchisor nonsense, because dealers cannot retail what they cannot get.

High customer demand for new and used vehicles, stymied by inventory shortages, will continue in 2023, though the problem will likely slacken. This reality is reflected in the numbers of America's new car sales in 2022, far below demand. On the other side of that equation, retail pricing has generally made dealer sales profitability a non-issue, although used car profitability is heading down, as of December 2022. Despite some cautionary signs about inflation, higher interest rates and the economy generally, dealers may reasonably anticipate overall dealership profitability to remain strong through the first half of 2023.

We note that, in late 2022, the National Automobile Dealers Association published a set of "Guiding Principles" that span a wide range of important matters for franchised dealers. *See* "*Principles to Guide Auto Retail's Future*," <u>www.NADA.org/principles</u>. These principles – to be updated from time to time – observe that the dealer business model is rapidly changing. This is a good thing, says the NADA, because dealers must and will adapt to both current and future developments.

The NADA's principles emphasize and extol the dealer franchise system as best for consumers. They stress the importance of dealers maintaining and improving what they do in sales and service. Dealers must preserve their ability and right to service and sell vehicles, to the exclusion of both "legacy" carmakers and others aspiring to be not only manufacturers, but also direct retailers. This is principally because franchised dealers are best positioned in experience and talent to serve the interests of consumers, and they assure healthy price competition among dealers. Factory direct sales would extinguish same-brand price competition. All franchised dealers should thoroughly study this valuable NADA publication, and be on the lookout for anticipated updates.

As all the Top 30 Trends indicate, dealers in 2023 must pay close attention to many hot legal issues. Failure to do so increases dealer risk in a host of areas.

> *The ranking of the top thirty legal issues/trends is based on three factors: (1) the likely number of dealers affected; (2) the probability of change from the current situation; and (3) the seriousness of a trend/issue impact on the lives of dealers.*

1. The Supreme Court and the Federal Regulatory Arena: How Two Decisions of June 2022 and Subsequent Court Actions Could Signal for 2023 a Healthy and Profitable Regulatory Reshaping for the Auto Industry, Dealers and Consumers, Despite Administration Efforts to Deepen Regulations.

Two SCOTUS decisions at the end of the 2021-2022 term could mark the beginning of a legal trend that auto dealers, manufacturers and consumers would welcome. This arguably good news for dealers flows from language in the *Dobbs* and *West Virginia* cases that may inhibit federal agencies and even Congress from creating broader swaths of government control over dealerships and other businesses. Measured in administrative and regulatory expenses, this trend could save dealers, on average, a half million dollars per year, and, in some specific instances, many times that figure.

The United States Court of Appeals for the Fifth Circuit ruled on October 20, 2022 that the funding of the Consumer Financial Protection Bureau "violates the constitutional structural separation of powers." *See Community Financial Services Association of America, Limited v. CFPB*.[1] This landmark decision will likely be upheld by the full appellate court, and by SCOTUS. Specifically, the case eliminates the CFPB's rule restricting payday loan practices, but it potentially has wider ramifications, even on past CFPB actions.

"Chevron deference," alluding to the case of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), is now probably dead. No longer will federal courts defer broadly to U.S. agencies that claim wide power to interpret ambiguous laws, and to make and enforce regulations, unless the Congress has delegated such authority with unambiguous specificity. *Dobbs*, which sent back to the states the power to regulate the parameters of abortion rights, sends a message that, where the Constitution does not clearly express it, an individual constitutional right should not be inferred by SCOTUS. Essentially, *Dobbs* and *EPA* seem to be a return to an acknowledgment of states' rights under the Tenth Amendment and the wisdom of James Madison's Federalist No. 45 view that the federal government enjoys only those "powers delegated by the proposed Constitution [which] are few and defined." All other kinds of governmental powers, he wrote, "are to remain in the State governments, [and] are numerous and indefinite." *Bottom line: The FTC's pending proposed new regulations contain overreaching requirements for dealers, but the SCOTUS decisions of last year hint at the agency's legal jeopardy. One extreme example of FTC overreach is its proposed requirements that dealers retain "all written communications relating to sales, financing or leasing between the [dealership] and any customer who signs a purchase order or financing or lease contract." NADA's Paul Metrey, Senior VP of Regulatory Affairs, who submitted NADA's lengthy, scholarly, persuasive, and robust challenge to the FTC's proposal, says the FTC has "absolutely no justification" for such "unbelievably burdensome" requirements. See also John Huetter, "FTC proposal on saving records 'extreme': Drafted rules suggest that dealerships save sales staff's texts with customers." Automotive News, Aug. 15, 2022. In my opinion, the FTC's proposal will not become law.*

Watch for many developments from the federal judiciary in 2023 to limit the FTC's quest to over-regulate dealers. That is a good trend, buttressed for now in an October 2022 Fifth Circuit case that strips the CFPB of its funding source, because, in the Court's eyes, funding via the Federal Reserve is an unconstitutional abridgment of a congressional power.

2. The Factory Direct Sales Battle, "Agency," and EVs

For decades, "legacy" auto franchisors have longed for the legal ability to retail directly to consumers in all states, notwithstanding the many current state laws prohibiting the practice. Tesla, which is not a franchise operation and has no "dealers", has been conducting direct sales for years, albeit with specified limitations in many states. Other non-franchise carmakers are doing direct sales (*e.g.* Rivian), and the battle roars on. Unsurprisingly, traditional "legacy" brands still seek the ability to retail themselves, especially with EVs.

The factories have plenty of media support in criticizing what they call a "dealer cartel," whereby state regulations "have made it impossible to sell cars without having car dealers as a middleman." Editorial, "Freeing EVs From the Dealer Cartel," *The Wall Street Journal*, Nov. 14, 2022. As always, on this issue, *The Journal*, the factories and their supporters ignore altogether the many benefits to consumers of requiring local, licensed franchised dealers to compete for sales and service business. They never

[1] This case has lots of history, and has been back and forth in the courts for years. The details are presented in a scholarly and interesting October 2022 Opinion, and are beyond the scope of this annual article.

mention, for example, any rebuttal from the NADA or state associations.

These anti-dealer advocates, however, have their facts wrong. The state laws that bar factory retailing are pro-consumer and in the public interest. Without these laws, same-brand competition would cease, and monopolistic pricing would rule the day.

The "agency" concept (common in Europe) whereby a factory sets up retail sales terms and conditions, and then gives local dealers "commissions" for deliveries, may be seen as a clear path to move automakers toward direct retail sales.

The evolution of EVs – in technology, pricing, availability, and tax treatment is terribly complex and developing. It seems certain that EVs on the roads will continue to proliferate, but perhaps not as rapidly as forecast. As the NADA stresses in its new Guiding Principles, legacy branded EVs should be retailed by franchised dealers, and not by the factories.

Bottom line: For 2023, dealers should continue to prevail in limiting direct retail sales to those manufacturers, such as Tesla, that do not have dealer franchisees. Despite emotional and fact free support from The Wall Street Journal and others, *legacy automakers' strategy to allow EVs to be an exception to widespread state prohibitions against direct factory sales will almost surely fail.*

3. Supply/Product Shortages, Inflation, Microchips, Allocations and All That.

Most dealers remained profitable – very profitable – for CY 2022, and early indicators suggest that dealer profitability may continue into or beyond CY 2023, though perhaps not nearly as robustly as in 2022. Going into 2023, used car profits are tumbling downward. At the same time, dealers are well aware that vehicle and parts shortages continue for now. Microchip shortages still stymie production, particularly because chip varieties and complexities are exacerbated by the expanding needs in electronics, for both internal combustion engine (ICE) vehicles and especially in the onslaught of EVs.

No one can predict with certainty when the shortages of new vehicles, parts and chips will abate or end entirely. Used vehicles are also in short supply, though their profitability is not nearly as high as it was in early 2022. Most dealers have appreciably decreased their purchases at auction. Instead, they emphasize contacting their own customers, buying back vehicles that were purchased from them new, and offering premium trade-in prices. *See,* C.J. Moore, "Disruptions shift focus away from auctions." *Automotive News*, Oct. 3, 2022. By mid-2023, though, some observers anticipate growth in supplies of new and used cars to "near normal."

In my opinion, high profits in sales of both new and used vehicles will be less consistently sustainable, especially so with used. The third quarter of 2022 saw a huge drop in the profitability of used cars at the dealerships of public companies. Jack Walsworth, "Used-vehicle profitability tumbles for public dealership groups; Q3 declines range from 11% to 31%." *Automotive News*, Nov. 4, 2022. *See also*, "Carvana shares plunge to record low as used-car prices fall fast: Shares of the auto retailer have sunk more than 53% in the two trading days since the company reported disappointing third-quarter results law week." *Automotive News*, Nov. 7, 2022.

High inflation, rising interest rates, and a weakening general economy should also give dealers concern. *See,* John Huetter, "Economy, interest rates sour dealer views on market, survey finds." *Automotive News*, Dec. 7, 2022. While it is true that dealers can still generally retail whatever new inventory they receive, they often have to sweat out the deliveries of vehicles for restocking. As America's leading auto publication wrote last summer, "for economists and analysts employed in the dark science of forecasting, the times are just nuts." Lindsay Chappell and John Irwin, "Auto industry forecasting is suddenly really tough." *Automotive News*, Aug. 8, 2022.

Inflation may still be the main economic driver – or depressor – but increased interest rates are a close second. After the Jackson Hole, Wyoming conference that included financial experts and leaders from around the world in August 2022, Fidelity Investments reported:

> The message from the world's top finance chiefs is loud and clear: Rampant inflation is here to stay and taming it will take an extraordinary effort, most likely a recession with job losses and shock waves through emerging markets.

Although inflation, a world-wide phenomenon, is and will remain in play for some time, the U.S. will share in the pain while economists hope that Fed Chair Jerome Powell presides successfully over Fed rate increases calculated to tame inflation. As Powell said to the audience at Jackson Hole, "These are the unfortunate costs of reducing inflation. But a failure to restore price stability would mean far greater pain." For a quick and sensible explanation from a world class economist of how inflation works and how federal monetary policy impacts inflation, see "*What causes inflation? John Taylor explains.*" Stanford Institute for Economic Policy Research, Sept. 6, 2022.

Bottom line: I predict another year of dealer profitability in 2023, but not nearly as robust in gross sales profits as 2021 and 2022. 2023 could see a recession across the U.S. economy, and world-wide, but dealers will suffer less than the potential hit to the overall economy. Inflation will continue to do injury to American consumers, in part, because inflationary fires take time to put out. Ironically, federal action could actually worsen consumer woes for a time because the Fed's rate increases could keep interest rates high for consumers who, unsurprisingly, are keeping their cars longer.

4. Economic Uncertainty for Dealers: Despite a Time of Record Sales Profits and Upticks in Service Business, Inflation, Rising Interest Rates, and Supply Chain Disruptions Potentially Cast a Long Shadow.

Dealers continue to enjoy high profits in new vehicle sales and in service business and might do so through 2023. Yet they are wary of what is to follow because production still lags, and the future remains uncertain in terms of inflation and interest rates, as well as both supply and demand. Profits on used car sales tumbled in the third quarter of 2022. Most economists now agree that recession is more likely than not in 2023 or 2024, but America's dealers nevertheless could see another relatively good year in contrast with many other kinds of business.

Bottom line: Dealers live with lots of uncertainty, and 2023 will see plenty of it. As availability of new vehicles likely rises a bit in 2023, so will retail transaction prices level off – even with new vehicles. The same may be said of service business. See Lindsay Vanhulle, "Dealerships' service business is strong, but not without challenges: Dealerships' service and parts businesses are doing well as consumers hold on to older vehicles longer. But issues exist, including mechanic shortages and parts availability." Automotive News, Oct. 16, 2022. Also, the rising tide of OTA repairs and updates will continue to cut into dealership profits. See Trend # 10.

5. How the Misnamed Inflation Reduction Act (IRA) Affects Dealers.

Take this as a given: Despite the title, the IRA does not and will not reduce inflation. *See* Trend #4, above. Even its most vigorous promoters say that, for at least a few years, the IRA impact on inflation will be zero. Instead, the core of the new law is crafted to further the quest to slow climate change. This reality is buttressed by general independent studies, including one from the CBO. The IRA will affect dealers because it emphasizes huge monetary subsidies for EVs:

> The [law] enacted in August contains billions in incentives to support EV and battery manufacturing in the US, and revamps a tax credit for consumers buying EVs by setting stringent sourcing requirements eliminating eligibility to vehicles made in North America.

Audrey LaForest, "How will the midterm elections impact the auto industry? Under a GOP-controlled Congress, several policy experts said they would expect to see a shift from a more active legislative agenda to congressional oversight over the Biden administration's regulatory authority." *Automotive News*, Oct. 30, 2022. Thus, the IRA title is a misnomer, because its real target ignores inflation, and, instead, promotes green energy through the advancement of the EV industry.

Bottom line: High inflation and steep interest rates are almost certain to plague the economy through 2023, and perhaps thereafter. This is a consensus conclusion from respected analysts who are not partisan. The IRA will impact dealers negatively, but not enough to dramatically lower profitability for at least the first half of 2023.

6. Taxes

For dealers, the complex tax ramifications of the Inflation Reduction Act will be profound and confusing. *See, e.g.,* Audrey LaForest, "Tax break rules could reshape EV supply chain." *Automotive News,* Aug. 15, 2022. In addition, Last-In, First-Out (LIFO) tax treatment is subject to ongoing revision by the Congress.

Bottom line: Dealers need to carefully monitor how tax rules and interpretations may affect both the EV marketplace, and their own transactions.

7. The Future of Auto Franchise Laws.

It is nothing new to hear or see reports of possible challenges to the auto franchise laws of fifty states that provide an assortment of protections from the auto manufacturers. These protections range from prohibiting discrimination against auto dealers in product allocations to the codification of significant dealer rights in contesting franchise terminations or the establishment and relocation of same-line competitive dealerships.

Now more than ever, however, pressure is mounting in many states to make meaningful changes, many of which would attempt to erode or even do away with the protective nature of many of the state laws. *See* Lindsay Van Hulle, "Future of franchise law is up for debate: Old model is under threat, dealers say." *Automotive News*, Jun. 6, 2022.

Discussed elsewhere (Introduction) is NADA's "Guiding Principles" publication, which details powerful reasons why the auto franchise system will evolve and flourish. This publication has garnered major attention throughout the automotive industry and in the press. The overall take-away is a positive picture for franchised dealerships for the foreseeable future.

Bottom line: The good news for dealers is that protective auto franchise laws in all states will not diminish anytime soon. The bad news is that dealer associations and their counsel will still have to fight with vigor for their continuation. The NADA vows to lead that charge. With large dealership groups and more consolidation, dealer legal power will continue to grow, and this trend will also help to overcome challenges to franchise laws.

8. Dealer Policies Embracing Diversity, Equity and Inclusion (DEI): Identity Politics and SCOTUS on Affirmative Action.

DEI is a really hot topic across all segments of American society and business. Even lawyers are now required in most states to include a few hours of DEI training in their state continuing legal education sessions. Auto dealers ignore DEI at their peril – both from a legal standpoint and in the public image.

Nevertheless, at a SCOTUS oral argument in two cases on October 31, 2022, a possible majority of Justices hinted strongly that they might end or limit affirmative action with race as a factor in university admissions. In those matters, Plaintiffs asserted that race-based admissions at Harvard and the University of North Carolina are unlawful and unconstitutionally discriminatory. A majority of the justices signaled agreement with Plaintiffs' side. *See* German Lopez, "Affirmative Action's Future: The Supreme Court seems poised to end the policy." *New York Times*, Nov. 1, 2022. Such an outcome would reach far beyond the gates of the two Defendant academic institutions. Auto dealers should know that their DEI policies that favor employees based on race or ethnicity would probably come under legal fire for alleged discrimination.

Today's universities, corporations and other institutions see virtue in "equity" programs in which they hire and promote people, using favored races or ethnicities as explicit positive factors. Thus, chosen minorities may be selected over those lacking any preferred minority status. That is the explicit issue pending before SCOTUS. Should the Court rule for Plaintiffs in the pending cases, there will undoubtedly be discrimination lawsuits in almost every walk of American life, asserting harm caused by racial and/or ethnicity bias.

Bottom line: For the time being, DEI is woven into the fabric of dealership workforce policies, just as it is with automakers and other American businesses and institutions. If SCOTUS outlaws or limits the affirmative action policies at Harvard and UNC, however, the heat of the debate over DEI in hiring and promotions across a broad spectrum will be even more intense than it is now. Dealers would need to revisit existing DEI policies, either to tailor them to SCOTUS's holdings or to make sure their policies are compliant.

9. The Death of MSRP, Sort Of.

In early 2021, most dealers were, most of the time, retailing new vehicles at prices below the Manufacturer Suggested Retail Price ("MSRP"). Across nearly all brands, dealer gross sales profits on new cars were remarkably low. To be profitable, dealers relied on other profit centers for overall profitability, such as F&I and used cars. One and two years later, however, new and used gross sales profit numbers went through the roof. During 2022, average retail transaction prices reached an all-time high of over $46,000 – over 4% higher than in 2021. Kiplinger reported in November 2022 that the average new unit price exceeded $48,000.

According to the *Wall Street Journal*, by mid-2022, more than 80% of dealers were selling at or above MSRP, up from just 2% just a year earlier, and 0.3% in 2020, says the *Washington Post*. Although this trend of beating MSRP at retail is making the automaker franchisors unhappy, it appears that consumers are content for now to pay over MSRP for their cars – sometimes much over – without much of a whimper.

That stoicism does not, however, apply as much to other products and services, including groceries, gas, restaurant fare and air travel. Consumers want their new cars! Nevertheless, some manufacturers decry the over-MSRP trend, and consumer dissatisfaction with sky-high car prices may emerge in 2023.

Bottom line: Before the world-wide supply shortages of motor vehicles, dealers and their franchisors mostly adhered to a belief and practice that retailing above MSRP was the kiss of death. For now, however, retail customers will not punish dealers for charging over MSRP for new cars, sometimes even way over MSRP for certain especially desirable models. Anecdotally, reports of occasional retail prices $50,000 or more above MSRP have surfaced. Even so, some carmakers are trying to coerce dealers to impose a retail ceiling of MSRP. Dealers who continue to cross the line, however, believe they will not suffer meaningful adverse consequences.

The over MSRP phenomenon will continue as long as desirable vehicles remain in short supply and that reality will go well into 2023. Consumer resistance to high used car prices seems to have taken hold already. The same development may arrive for new cars by late 2023.

10. Where Over-the-Air ("OTA") Repairs and Updates are Heading, and the Effects on Dealer Service.

Nearly all brands now have the capability to remotely repair and/or update their vehicles in growing ways, without consumers having to take them to dealerships or anywhere else. Tesla has been the industry leader in this area, but legacy brands are following suit. In general, with EVs, consumers need to visit a dealership less frequently for in-the-shop work, and we will see more OTA work in 2023 and beyond.

This trend has already reduced the amount of service work done at the dealerships of a growing number of brands. As electronic features become more prominent, the OTA work grows exponentially. When such OTA work is free to the consumer, it is not a situation in which the dealer can claim a right to payment. It is a different story, however, when a factory charges the consumer for OTA additions. A new law in West Virginia in 2022 has led the way in assuring that dealers get their "fair share" when OTA work requires payments from a consumer. The NADA's "Guiding Principles" envision a fair treatment of dealers in deriving OTA revenues.

Bottom line: Dealer service business will continue to decline sharply as more and more "traditional," service work is accomplished via the expanding OTA capability of all brands, especially with EVs. State associations and NADA are working on ways to allow dealers to reasonably share in the for-pay aspects of OTA upgrades and repairs.

11. Cyber Craze: Dealers Avoiding Liabilities, Ransomware, and Invasion by Cyber and Identity Thieves While Maintaining State-of-the-Art Cyber Capabilities; FTC Amended Safeguards Rule: Protecting Your Data and that of Others.

Like other businesses, dealerships cannot operate efficiently without sophisticated, user-friendly websites and other state-of-the-art software and hardware. Updating capabilities is critically important – both in taking advantage of new features, and in fending off new and invasive criminal developments. In today's business world, this costly reality is simply how it is. No one argues otherwise. While cyber capability (including online sales) and constant improvements are necessities, criminals are also more and more aggressive and knowledgeable in their cyber thievery.

Bottom line: Dealers must now invest extraordinary funds and resources to be cyber capable and savvy. Concurrent training and hardware/software updates are also musts. Almost every employee needs a computer and a cell phone, and dealers must stress to them the requirements of cyber-security while on the job.

It cannot be over-emphasized that dealers must stay alert to ever-more clever schemes to defraud them via their dealership websites and other cyber portals. Dealers are well advised to understand and deploy the FTC's Amended Safeguards Rule, as described by the NADA in its updated guide – readily available online. The amended FTC Rule is stricter than earlier *versions. Compliance with the new rule must be in place by June 2023. See Gail Kachadourian Howe, "Getting cybersecurity rules right is no small task." Automotive News, Dec. 4, 2022. Remember: The protection of personal/private information of customers and employees is a paramount priority, along with dealership's own proprietary data.*

12. Buy/Sells: Still High Values, But Fewer Sellers: "A new era of consolidation, reshaping the retail industry," says *Automotive News.*

2023 is almost certain to see a continuation of dealership businesses sold at high prices, with high blue sky valuations and soaring multiples. Prominent brokerage companies like Haig and Kerrigan and others forecast some tapering in rooftops sold – lots of buyers out there, but few sellers. Consolidation continues, with public companies and multi-franchise operations seizing a lion's share of decreasing by dealer rooftops.

Bottom line: It is a seller's market. "Dealer outlook cools on acquisitions. Nearly half of dealers plan to buy one or more dealerships in the next 12 months, while only 2 percent expect to sell in that time frame, according to a survey by Kerrigan Advisors." Julie Walker, Automotive News, Nov. 6, 2022. Record valuations for blue sky continue, and buyers who want to buy must search far and wide, especially for luxury brands, and they pay a premium. This favorable seller's trend should go beyond 2023.

13. Manufacturers Pressuring Dealers on Facilities and Performance: Importance of Written Dealer Responses to Franchisor Threats.

Written factory threats to dealers about alleged adequacy of facilities and sales performance have become cottage industries. Usually, those threats include: (a) a litany of data to show the dealer's alleged inadequacies; (b) an expression of how and when the corrections must be accomplished; and (c) the potential consequences of non-compliance which may include a loss or reduction of incentives or other payments, and/or franchise termination.

Bottom line: When your franchisor threatens you with negative consequences for alleged poor performance, you MUST respond in writing. If the word "termination" is in a factory letter, the dealer's written response is urgent. Be prompt, factual, civil, and persuasive.

14. Pandemic Fallout from COVID-19: Dealer Operations and Permanent Changes.

Most dealers agree: After the COVID pandemic, routine dealership operations will never be the same as they were. Home pick-ups, deliveries and online purchases are everywhere now. Personnel activities and customer interactions will be even more friendly and thoughtful then they already are. Consumers overwhelmingly like the changes. The *Wall Street Journal* and other media report that some car customers vow to never visit a dealership in person again. But most simply enjoy the luxury of shopping from home, and having their cars picked up for service.

Bottom line: These developments are here to stay. Customers like the convenience and ease of shopping from home, and dealers have stepped up to accommodate them. For those who do visit dealerships, studies show that facilities are now cleaner than ever, and sales representatives are skilled in courtesy like never before.

15. Insurance Coverage: You Probably Need More: Cyber Insurance is the Fastest Growing Segment in Property and Casualty Insurance, According to Kiplinger. If Not Already Covered, be Sure to Also Consider Coverage for Disaster Coverage and Shutdowns.

Broad and deep insurance coverage is a wise and prudent choice for dealers. The amounts of coverage will depend several factors. Of late, premiums for all kinds of coverage have been rising. High deductibles can help to reduce premiums for the most expensive kinds of coverage. An area of special interest here is cyber insurance, within the overall category of property and casualty insurance. One bad experience with, for example, identity theft, has the potential of breaking the business. The wiring of money between businesses poses special risks and requires telephonic confirmation with a known contact before sending.

In recent years, we have seen instances of low or no insurance coverage for losses of all kinds. *See* Trend #22.

Bottom line: Every dealer needs to self-audit every year to update insurance needs, or to confirm that current coverages are satisfactory. Being under-insured has recently devastated some dealers. Premiums continue to rise, and 2023 will see the highest ever for all kinds of coverage.

16. Used Car Retailers and Departments Returning to Reality: Lower Profits.

Many dealers have been paying premium prices to consumers to acquire used car inventory through 2021-2022. 2023 might reverse this trend, as the third quarter of 2022 saw steep drops in used car profits. Low dealer inventories of both new and used vehicles motivated this historically unprecedented market action, but action in used inventory has been sinking. Inventory at auctions is down, and dealers need to exploit other ways to get used cars into stock – but now dealers will see lower acquisition prices, and less dealer profit in used retailing.

Bottom line: Dealers must still hustle and compete for the acquisition of desirable used inventory – at much lower prices than 2021 and early 2022. Although advertising and direct solicitations are now common ways for dealers to stock up on used inventory, the pressure of competition for acquisition has abated.

17. Consumerism

Regulators, lawmakers, and the law itself all favor the consumer. When disputes or complaints arise with consumers, most dealers bend over backwards to resolve them right away, even if they incur some monetary loss. That is a wise and practical approach in almost all situations.

Bottom line: Consumer complaints about dealer sales practices are *abundant, maybe more than ever before. Most of these events can and should be resolved face-to-face. Dealers should go the extra mile to avoid formal disputes with consumers.*

18. Dealers and Leadership

Leadership is not the same as management. Good leaders are usually good managers, and good managers can be good leaders. Great or good leadership, however, also includes the qualities of inspirational example-setting, empathy, fairness, total integrity, and other positive intangibles. The best and most profitable dealerships must have outstanding leadership.

<u>Bottom line</u>: Dealer owners should try to be selective in hiring, developing, and keeping leaders within their stores. The many intangible strengths of those who inspire your employees make your store a better place. Excellent leadership yields higher profitability as well as loyal and hard-working employees at every level. It goes without saying that dealer owners should prioritize and hone the development of their own leadership skills. Set the example.

19. Properly Coping with the Customer Satisfaction Index (CSI).

For decades, the ways factories have measured the satisfaction of consumers with their dealers' sales and service have changed frequently. The statistical reliability of customer satisfaction "surveys" and resulting indexes have never been demonstrated. Even so, the resulting "scores" or "measurements" can mightily impact payments to dealers. Most surveys focus on customer loyalty – loyalty to the specific dealer and to the brand being retailed.

Auto franchisors want their dealers to attract repeat business, and that goal is sensible and admirable. Yet, CSI does not accomplish that lofty goal.

<u>Bottom line</u>: As many dealers put it, "you have to play the CSI game." Their point is subtle, yet clear. <u>All</u> dealers want to satisfy their customers. <u>All</u> dealers want customers for life. At the same time, they recognize that factory methodologies to measure <u>actual</u> satisfaction are flawed. The measuring methodology is unreliable, and sometimes surveys simply do not reflect the realities of actual sales and/or service experiences. Thus, dealers have a double-barreled "satisfaction" mission: (1) Satisfy your customers in the real world and make them want to come back; and (2) Do the tasks that cause customers to respond favorably in surveys. Of course, CSI and real-world customer satisfaction have some commonality, but no auto franchisor has yet proven any scientific validity to CSI methodology.

There are some rules of the road that are important to every dealer coping with CSI. First, recognize that CSI scores can be deeply important to dealers in terms of the factory's monetary rewards and incentives. They can also be used by factories when a dealer applies to acquire another franchised operation. Three years of CSI records are often the part of an application package.

Thus, dealers must "play to" their interactions with consumers to make sure they provide an accurate and positive impression – both for real world impact <u>and</u> to gain outstanding survey reviews. DO NOT EVER cheat by doing anything dishonest in influencing a consumer to deliver a better survey! NEVER suggest doing a survey for a customer. NEVER give anything of value to such a consumer or do anything beyond the usual and customary informational comment that the customer may be getting a survey. You can say, for example, "we hope that we are doing everything to meet and exceed your expectations, and that you would share that honest view in any survey."

20. The Practical and Legal Effects of the 2022 Federal Midterms on Dealers, and Hints for 2024 Elections.

To put it mildly, the November 8, 2022 midterm elections, state and federal, were marked by unprecedented levels of political and personal antagonism. The post-election results were not finalized until December 6 in the Georgia Senate race, and the House races lingered for weeks after the election in a few instances. When the results became final, the Senate stayed in effective Democrat control with a 51-49 majority, and the House gave a narrow edge to Republicans.

Hopefully, 2023 will settle into more "normal" times, marked by at least a modest softening of federal regulations that are so costly, onerous, and wasteful for dealers. The take-aways for dealers from votes cast in November 2022 are these: First, with the shift in the House majority, federal regulatory schemes that impact dealers <u>could</u> slow down somewhat. Second, the evidence of division proves once again that politics, particularly elective politics, should <u>not</u> be the subject of discussions within the dealership.

Contrary to widespread predictions and polls, the House and Senate left the congressional makeup very close to what it was for the previous two years. However, the change in the House majority is apt to reinforce the SCOTUS notion that agencies cannot overstep the boundaries allowed them by explicit congressional delegation.

<u>Bottom line</u>: America is less than two years away from the <u>next</u> election cycle for every seat in the House of Representatives, along with about a third of the Senate seats. On the same 2024 ballot, there will be the election for President. The electoral process and who holds federal offices could affect many aspects of dealer operations, including products retailed, the pace of EV expansion, workforce rules, environmental requirements, and customer habits and attitudes.

21. Recalls

Factory recalls have become commonplace in America's auto industry, with millions of affected vehicles placed into recall status each year. 2023 will be no different. The main reason for these astronomical numbers is the apprehension of liability for defects, especially for damages when someone is injured because of a defect. Also, many states prohibit the sales of cars under safety recalls, without first remedying the reason for the recall.

<u>Bottom line</u>: Dealers must stand up for themselves when their franchisors try to foist any of the costs of recalls on their dealer networks. Recalls stem from factory defects and the entire cost should be borne by the carmakers.

22. How to Address Dealership Risks of Natural Disasters, Crime, Unrest, Terrorism and (Other) Pandemics.

Hurricane Ian was the latest reminder of how profoundly a natural disaster can affect or even devastate dealer operations and other businesses. Although they seldom occur in any specific locale, a host of possible horrific events should motivate American auto dealers to take a few relatively modest steps to prepare for the worst.

Bottom line: Below is the author's sample list of overall basic steps to take in anticipation of a terrible and unanticipated event:

1. *Distribute a regularly updated personnel roster to everyone in a managerial position at the dealership;*
2. *Distribute a "call list" so that everyone in the store knows whom to call in any emergency situation;*
3. *Practice the emergency call routine at least once a year;*
4. *Identify a safe place where employees and dealership visitors should go in the event of a sudden emergency during business hours; spell out the differences among different kinds of emergencies;*
5. *Make sure that responsible employees have assignments to move vehicles to specific locations if a serious weather event is predicted. Refer to Emergency Procedures in all-hands meetings at least once a quarter;*
6. *Explore and, if possible, obtain insurance for these kinds of events;*
7. *Keep an updated list of places for employees and their families to seek assistance in obtaining lodging, food, and medical care if necessary;*
8. *Post prominently telephone numbers for police and medical help, including but not limited to 911;*
9. *Maintain a transistor radio at the dealership to access emergency information during outages; and*
10. *Identify and make known a responsible person at every store location to oversee dealership actions and responses during an actual emergency.*

Nothing can immunize anyone from all the consequences of a disaster, natural or man-made. However, experience proves that implementing the items in the above list, and preparation and training can lessen, or help to cope with, the harmful impacts and the personal angst when a terrible event happens. It is a relatively easy task to keep people informed to alleviate the harsh realities of an unexpected emergency. All dealers should implement the list, and assure that all employees understand it.

23. Workforce Issues

Every dealer must adhere to a plethora of federal, state and local laws, regulations, and ordinances that affect the dealership's workforce. Salary, wages, and commissions are just the beginning. Questions of discrimination, hiring, firing, working conditions, dress codes, sick leave, and vacation time have launched innumerable court cases around the country.

Bottom line: Dealers must keep a sharp eye out for legal developments affecting workforce issues, because material changes can occur rapidly.

24. Rights of First Refusal (ROFRs)

When dealers enter into buy-sells and forward them for approval, anecdotal information suggests that America's auto franchisers exercise their ROFRs very sparingly.

Unfortunately, there exists no reliable database to calculate the number of the actual exercises of ROFRs in America. Anecdotally, though, it appears that the exercise occurs less frequently than a few years ago, but the specter still looms large with both dealer owners looking to sell, and with those looking to buy a dealership.

Bottom line: Buyers and sellers of dealerships are wise to evaluate the possibility of an auto franchisor, exercising its contractual ROFR as soon as a buy-sell is under consideration.

25. Alternative Dispute Resolution (ADR)

In American law, ADR is now a cottage industry, and dealers are frequent participants. Face-to-face settlement meetings, mediation, and arbitration are the three most commonly used techniques of ADR. Although federal law (since 2002) bars automakers from foisting mandatory arbitration upon dealers in their dealer agreements, the other forms of non-binding ADR are sometimes required prerequisites for a dealer going to court. Arbitration can be available to dealers in disputes with their franchisors if both sides agree to it after the dispute arises.

Bottom line: There are a number of versions of ADR provisions for retail agreements with consumers. Dealers should give their customers a clear and conspicuous opportunity to sign for arbitration and rule out class actions or joining multiple parties and claims. But take care to follow what is permissible in your state.

With their auto franchisors, dealers often achieve in mediation a quick and satisfactory resolution of what could otherwise be an expensive and agonizing dispute. Take advantage of this ADR method, if available. If not mentioned in the dealer agreement, ask for mediation anyway to try to amicably resolve any serious potential problem. If mediation fails, you still have the alternative of a formal dispute mechanism, in court or, possibly, in an administrative proceeding.

26. Autonomous Vehicles

For many reasons, including tech delays and highly publicized accidents, the phenomenon of self-driving cars has developed more slowly than many predicted. The worst of the publicity is probably the highly publicized criminal investigation of Tesla for its safety claims, in the face of "more than a dozen crashes, some fatal, involving Tesla's drivers assistance system, Autopilot." "Tesla faces criminal probe in U.S. over self-driving claims." *Reuters*, Oct. 26, 2022. Consumer advocate Ralph Nader called Tesla's self-driving technology development "one of the most dangerous and irresponsible actions by a car company in decades." He added that "Tesla owners are currently using technology that malfunctions every eight minutes." *See Nader.org*, Aug. 10, 2022. Although Nader's comments focus on Tesla, consumers will inevitably have similar concerns about the safety of autonomous vehicles of all brands.

Bottom line: Despite the avalanche of investments, besieged by reports of unsafe technology, the general acceptance of self-driving cars will take years longer than once anticipated. See Jerry Hirsch, "Reality check: $160 billion can't get autonomous vehicles on road: Investors have poured $160 billion into the dream of autonomous transport over the last dozen years, but except for a few test programs, it remains a distant goal, and the path ahead is daunting." Automotive News, Nov. 4, 2022.

27. Succession, Legacy and Estate Planning

No dealer should avoid or delay succession planning. Unfortunately, some do fail to make or update wills and associated legacy plans, and sometimes leave survivors and heirs with a chaotic aftermath.

Bottom line: Each year dealers should consider whether their estate planning, including a will, needs updating. Changes in applicable laws and personal circumstances occur often.

28. Encroachment and Franchise Modification

Encroachment refers to the establishment or relocation of a same-brand dealership in a location in some defined proximity to your dealership.

Modification is when the factory decides to change a material aspect of the dealer agreement. Many states now permit dealers to protest a proposed modification.

Bottom line: Encroachment has become relatively rare. When the factory does provide notice of an establishment or relocation to a protestable location, you should almost certainly protest under state law.

A growing number of states now permit dealers to challenge unilateral material modifications to dealer agreements. Many of those laws provide that the modification is stayed while a challenge is pending.

29. Warranty Reimbursement

Warranty reimbursement questions still arise from a few recalcitrant manufacturers, but for the most part, the issue has subsided. Most dealers of most brands now receive reimbursement at retail for both parts and service, or at least a reassurance from those franchisors that their version of retail is what they are paying. There are, however, sometimes issues over whether the dealer has submitted adequate evidence of what their true retail rate may be.

Bottom line: This area is fairly quiet now, or at least quiescent. When any dealer has a disagreement about whether reimbursement is being paid, consistent with state law, such a dealer should never be shy about raising the issue directly with the appropriate rep. Most such matters are resolved quickly, and formal disputes are now rare.

30. Franchisor Audits

As every dealer knows, factory audits happen in the ordinary course of business, and in most instances, an audit is perfectly lawful and covered by the dealer agreement. In rare instances, the factory may be trying to audit something that violates a state law's time limits or may be motivated by bad faith as the dealer sees it.

Bottom line: Unless the dealer has unusual circumstances or special facts, cooperate fully with auditor. Make sure they communicate only with employees approved by you. Let them see documents requested, and give them space to work where they cannot interact or be seen by employees and customers. ■

Eric L. Chase is an attorney and a member of Bressler, Amery & Ross, P.C., a law firm with nine offices in six states and the District of Columbia. [Cell: 973.919.9445] Mr. Chase devotes a significant part of his practice to the representation of franchised automotive dealers nationwide, and he has been lead counsel in numerous landmark decisions. He has authored over 100 published articles in this field and nearly 200 altogether. He is a frequent guest speaker to dealer and professional associations and other automotive-related audiences. His biography appears in *Who's Who in American Law, Who's Who in America* and other similar publications. For many years, Mr. Chase has continued to be selected by his peers as a Super Lawyer. He holds a B.A. from Princeton, a J.D., *cum laude*, from the University of Minnesota, and a Graduate Certificate in International Security from Stanford. The views set forth in this article are his own and do not necessarily reflect the views of his firm or any of its clients. Nothing in this article is intended to constitute legal, financial or tax advice. Each reader should consult with his or her professional advisor regarding any such advice.

NADC Member Announcements

Do you have an announcement or accomplishment that you would like to share with the NADC community? Please send any news that you would like to share to: emurphy@dealercounsel.com.

Erin H. Murphy
NADC Executive Director

Happy 2023 to all!

This issue marks the first 2023 publication of the *Defender*. We encourage all members to share their knowledge and experience with the NADC community by submitting an article to be published in the *Defender*. Please contact me at emurphy@dealercounsel.com or Editor Kyle Sipples at ksipples@autosavergroup.com for more information. Additionally, if you would like to take out an ad in the *Defender* please contact Jennifer Polo-Sherk at jpolo-sherk@dealercounsel.com.

As you review your 2023 calendar we encourage you to make plans to attend the **19th Annual NADC Member Conference, April 30 - May 2nd, at the Ritz-Carlton, Amelia Island in Amelia Island, FL.**

The planning committee is working hard to put together a program of educational sessions. As usual, CLE credit will be available. Preliminary topics will be released soon. Please watch your email for registration information.

The room rate for NADC members is $359 per night plus taxes. You may make your reservations online **here** or by calling 888-239-1217 and referencing "National Association of Dealer Counsel". Note that there are a limited amount of rooms for Friday, Saturday and Tuesday at our member rate.

Make sure to reserve your room by the cut off date, April 7th, or before it sells out, whichever occurs first.

Cancellation Policy: Reservations cancelled within seven days of arrival will be charged both the first and last night's room and tax. Guests who neither arrive nor cancel reservations will be charged room and tax for the duration of the confirmed stay. Guests departing before their confirmed departure will be charged room and tax for all remaining nights of the reservation.

Please make your reservation today!

Additional program information and registration will be available on our website, www.dealercounsel.com, soon.

Please be sure to stop by the NADC Booth at the NADA Convention & Expo – January 27-29 - in Dallas, TX. The NADC booth is #2809 - near the NADA Pavilion.

You can pick up a copy of your 2023 NADC Membership Directory, visit with NADC friends and colleagues, and even reserve the booth's conference space for meetings. Please contact Jennifer Polo-Sherk at jpolo-sherk@dealercounsel.com for more details.

I look forward to seeing you in Dallas and Amelia Island. Until then, wishing you all a happy, healthy and successful 2023! ■

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Updated Member Contact Information

Please make sure to notify NADC Staff (info@dealercounsel.com) if your contact information has changed so that your records can be updated accordingly. We will list updated contact information in *The Defender* so all members can be aware of the change.

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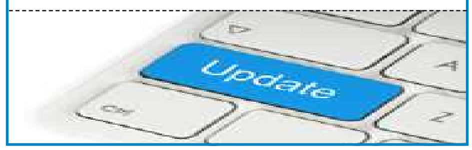

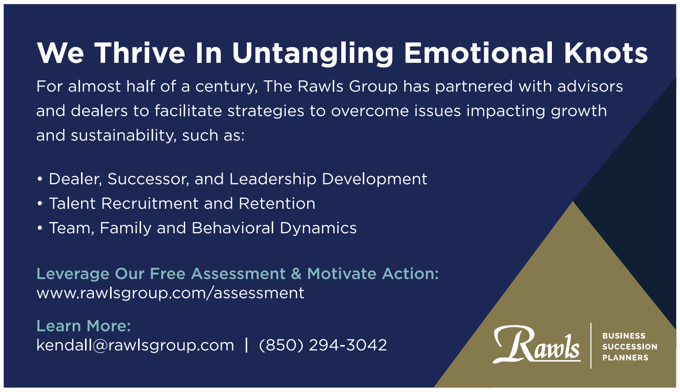
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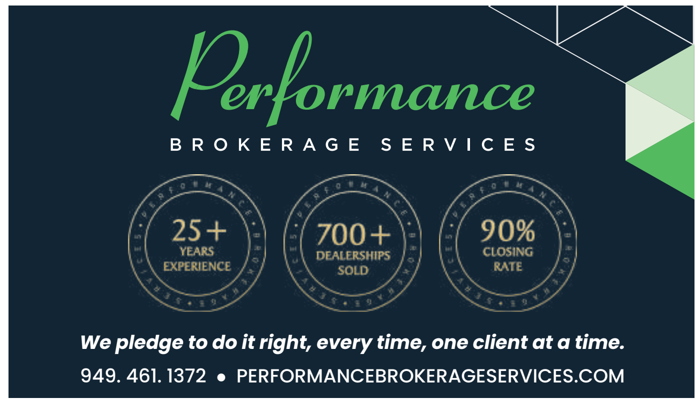
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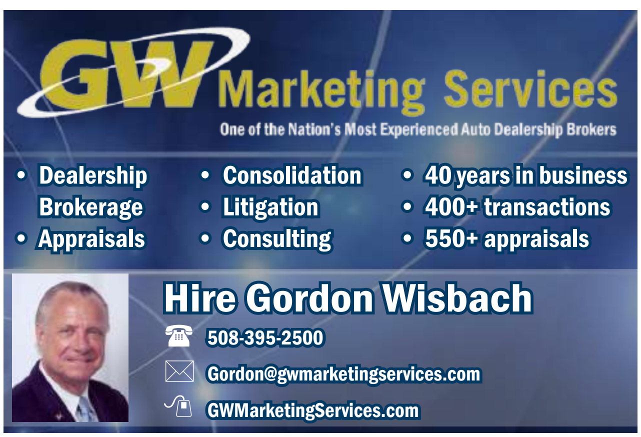
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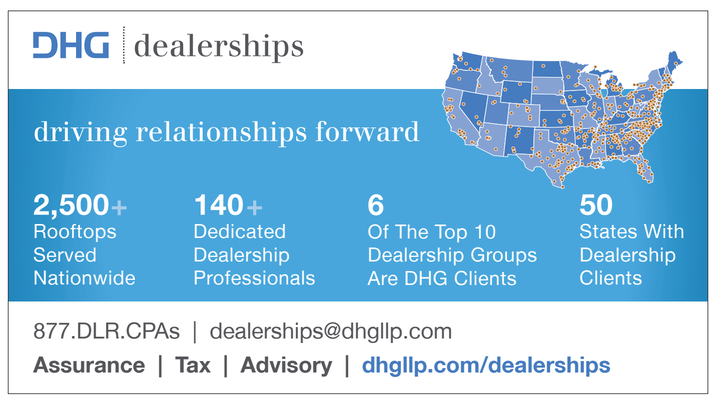
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